know whether there is net income or loss for such year. After the items in Sections 206 and 234 have been deducted and a loss results, there is no provision for them going back and disallowing certain deductions, whether they were allowed under Section 206 or Section 234, in order to eliminate any net loss resulting therefrom.

The Circuit Court of Appeals for the Fourth Circuit in *Burnet* v. *Moore Cotton Mills Co.*, 49 Fed. (2d) 59, in reviewing the decision of the United States Board of Tax Appeals in that case (17 B. T. A. 662), cited with approval the conclusion of the Board and its comment on Article 1602 of Treasury Regulations 62. That case dealt with a net loss provision in Section 204 (b) of the Revenue Act of 1921 which as to the "next succeeding (third) taxable year" had a provision similar to that in Section 206 (b) of the Revenue Act of 1926. The following quotation from the Board's decision was especially commented upon favorably by the Circuit Court of Appeals:

> "We find no ambiguity in either the first part or in any part of section 204 (b) of the Act of 1921. On the contrary, its provisions seem to us to be as clearly specific and unmistakable as it is possible to express them. Without doubt the Commissioner is endowed with the power to make and enforce regulations that shall carry out the clear intent of the words of this section, but equally the power given in the section does not imply that he has any authority to make or enforce any regulation that alters, or even modifies, that clear intent, and it would be without

effect even though that were the implication. The power of Federal legislation lies solely in Congress, and in our opinion that part of the regulation of the Commissioner which we have italicized and which provides that the excess of the net loss over the net income of the second year 'shall be carried over and credited against the net income for the next succeeding (third) taxable year' where Congress has clearly provided that 'the amount of such excess *shall* be allowed *as a deduction in computing the net income* for the next succeeding taxable year,' is an erroneous construction of that Act and goes beyond the power delegated to the Commissioner. We do not know whether it was the intent of Congress to provide that the deductions permitted, under certain circumstances, for the second and third years should be similarly applied; but we do know that such is not the effect of the language used in section 204 (b) of the Revenue Act of 1921; and that it is not within the power of the Commissioner so to construe and apply the widely differing provisions therein contained. The rule has been so well settled that it seems unnecessary further to discuss it or to cite authorities."

The Government's brief mentions the decision of the Court of Claims in *Swift & Co.* v. *United States*, 38 Fed. (2d) 365, as upholding its position in the instant case. We point out, however, that the Court of Claims decision had to do with an entirely different provision phrased in different language than the net loss provision in the Revenue Act of 1926. In the *Swift & Company* case the court was only concerned with applying the net loss for 1919 therein involved, *as a deduction* from *the net income* (i.e., after it is

determined) of the preceding taxable year (1918) under the Revenue Act of 1918, whereas in the present Woolford Realty Company case the Revenue Act of 1926 provides that the net loss shall be carried forward *as a deduction* in computing *the net income* (i.e., before it is determined) of the succeeding taxable year. In the instant case, the net income cannot be computed until the net loss has been deducted, while in the *Swift & Company* case, the net income was first ascertained and the net loss allowed in the nature of an offset or credit.

II.

Prior Decisions Discussed

The United States Board of Tax Appeals has consistently overruled the Department's present position in a long line of decisions:

> "The net loss of one of the affiliated corporations for the year 1926, at which time it was not a member of the affiliated group, operates to reduce the consolidated net income for the year 1927 under Section 206 (b) of the Revenue Act of 1926, even though such corporation having the net loss in 1926 also had a net loss in 1927."

Hawley Investment Co. 23 B. T. A. 953. See also *Alabama By-Products Corporation, et al.*, 18 B. T. A. 1919; *Ben Ginsburg Co.*, 19 B. T. A. 81,[1] *Buckie*

[1] Reversed (C. C. A. 2d) 54 Fed. (2d) 238. Following this reversal, the Board, in a case arising from the Second Circuit, has felt bound to follow the decision of the Circuit Court of Appeals. *Bowman Hotel Corporation*, 24 B. T. A. 1193. Otherwise the Board has been consistent in its conclusions.

Printers' Ink Co., 19 B. T. A. 943; *Pittsburgh Gasoline Co.*, 21 B. T. A. 297; *General Box Corporation*, 22 B. T. A. 725, 731.

To the same effect, *Burnet* v. *Moore Cotton Mills Co.*, *supra*, a decision by the Circuit Court of Appeals for the Fourth Circuit, as aforesaid, and *National Slag Co.* v. *Commissioner*, 47 Fed. (2d) 846, a decision by the Circuit Court of Appeals for the Third Circuit.

III.

An illustration and discussion of cases where the company, having a statutory net loss in a prior year to be deducted from gross income of the current taxable year, was a member of the affiliated group in both taxable years—to show the error of the Department's present practice.

The situation presented in the cases of The New York, New Haven and Hartford Railroad Company, the Boston & Maine Railroad and The Ohio Oil Company, for which the undersigned are counsel may be illustrated as follows:

	Affiliated in First Taxable Year	Affiliated in Succeeding Taxable Year
Company A—net income...	$100,000	$100,000
Company B—net income...	50,000	50,000
Company C—*net losses*.....	*250,000*	*50,000*
Consolidated loss.....	*$100,000*	
Consolidated gain.....		$100,000

We must assume for the illustration above set forth that the net loss of Company C for the first taxable year is the statutory net loss defined by Section 206 (b) of the Revenue Act. It is a quite generally accepted practice[1] to determine the amount of net loss for the first taxable year of any member of the affiliated group, to be carried forward, by deducting therefrom the net income of the other member or members of the affiliated group for the same year. In a case where there are several companies having a net loss in an affiliated group for the first taxable year, each company having loss absorbs its aliquot portion of the net income of the other companies. The unabsorbed statutory net loss of Company C in the above illustration, therefore, is $100,000 which

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[1] The Court of Claims in *Swift & Co.* v. *United States*, *supra*, in this connection stated:

"The answer to this is that in such a case, for the purpose of computation, section 240 [providing for affiliation] is a limitation of section 204 [the net loss provision of the Revenue Act of 1921] and that, in the computation under section 240, losses of one company must be offset against the income of the other companies before it can be determined whether there is a net loss of any company in 1919 which may be applied against its income for 1918. Obviously, if this were not done, the net loss which had been used to offset the income of the other companies in the consolidated group would be allowed again to reduce the income of the company which sustained the loss when applying it to the income of the prior year, and we think Congress did not intend a double deduction of this character."

Also see footnote "3" in the Court of Claims case; and likewise *General Box Corporation*, 22 B. T. A. 725, 731.

should be carried forward as a deduction in computing the net income of the succeeding taxable year.

The Department under its present rule, however, would not allow that amount of $100,000 as a deduction at all in the second taxable year. It would determine the consolidated net income for the succeeding taxable year at $100,000. If the loss can be carried forward, as the petitioner herein contends, there would be no consolidated net income for the succeeding taxable year upon which tax would be imposed.

We submit that the net loss provisions contemplate that there should be no consolidated net income for tax purposes for the taxable year where, in fact, as in the illustration above given, the operations of the two years have resulted in no real gain.

The Court of Claims in the case of *Swift & Co.* v. *United States, supra,* held that "the separate corporations are the taxpayer, and the affiliated group is merely a tax-computing unit, not a taxable unit."

As the court stated—

> "The consolidated group, as such, is not a taxpayer but a tax-computing unit, and the corporations which are members of the affiliated group for the year, or became members during the year, lose their separate identity while so affiliated only for the purpose of computation of the tax upon one income and one invested capital which is composed of the income and invested capital of such corporations combined, * * *."

Thus while the decisions have indicated that the carry-over of net loss and the computation therewith of net income or loss for the succeeding taxable year should be made with respect to each company within the affiliated group, and subsequently that the net incomes and losses of all the companies should be combined to arrive at consolidated net income, this procedure in substance is not different from combining the gross income of all the companies in the first instance and allowing therefrom the combined deductions of all the companies including the carry-over of net losses from prior years. Of course inter-company items in either event are eliminated and net loss will be carried over as a deduction in computing net income only to the extent that companies having the loss in prior years are within the affiliation for the succeeding taxable year. The result by either procedure is the same, and the court in the *Swift & Company* case, *supra*, so indicates—

> "In the enactment of section 240, Congress was simply laying down the principle that where a group of companies constituted a single business unit, the net income, determined in accordance with the general principles of law, should be *combined*, losses being offset against gains, and the *rate of tax* should be determined by the relation between such combined net income and the invested capital of the group as a whole, each corporation being at all times separately recognized and individually liable for its proportion of the tax according to the net income properly assignable to it."

Article 631 of Regulations 69 similarly provides:

> "Consolidated returns are based upon the principle of levying the tax according to the true net income of a single enterprise, even though the business is operated through more than one corporation. Where one corporation owns the capital stock of another corporation or other corporations, or where the stock of two or more corporations is owned by the same interests, a situation results which is closely analogous to that of a business maintaining one or more branch establishments. In the latter case, because of the direct ownership of the property, the net income of the branch forms a part of the net income of the entire organization."

Whether the taxable income or loss of the consolidated group for the succeeding taxable year is to be determined by combining the gross income of all the companies and subtracting therefrom the combined deductions of such companies, or the net income or loss of each company is first to be determined and thereafter added to or deducted from the incomes of the other companies to arrive at consolidated net income, each company within the group is entitled under the statute to the benefit of all deductions provided by law. These deductions include the unabsorbed statutory net loss of the prior year which is just as much a deduction in computing net income or loss for the succeeding taxable year as the deductions allowable under Section 234.

The real reason for affiliation and consolidated returns, provided for by Section 240 of the various